BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

I.

Opinions Below.

The opinion of the Circuit Court of Appeals has not yet been reported. The majority opinion and the dissenting opinion appear in the Record. (R. 145, 150)

The opinion of the Board of Tax Appeals is reported in 39 B. T. A. 101. The majority opinion also appears at page 15 of the Record. The dissenting opinion appears at page 32 of the Record.

II.

Jurisdiction.

This Court has jurisdiction under Section 240 (a) of the Judicial Code (28 U. S. C. §347 (a)), since this is a cause in which a final decree of a Circuit Court of Appeals has been entered.

The decree of the Circuit Court of Appeals was entered April 26, 1940.

III.

Statement of the Case.

A statement of the essential facts of the case is included in the petition. The following additional facts may be noted.

The Marshall land had been in the Marshall family since 1862; but, due to successive deaths and conveyances, there were, by 1917, various outstanding undivided interests. At that time George V. Marshall, father of the present beneficiaries, made plans to gather the various interests into one ownership in order that the land, together with adjoining land owned by others,

might be leased to a department store. Leases were accordingly entered into by the various owners in 1917, leasing the property to April 30, 1938. (R. 19-21, 41-42, 93)

On May 6, 1918, George V. Marshall died, leaving his interest in the property to Emma L. Marshall, his wife. She caused a corporation, the Marshall Land Company, to be incorporated in 1920 to facilitate the acquisition of remaining outstanding undivided interests in the Marshall land, and these were accordingly acquired by the corporation between 1920 and 1924. Emma L. Marshall later divided her stock in the Marshall Land Company among her four children, the beneficiaries under the present trust. (R. 22, 43-45)

In April, 1924, the department store, desiring to make extensions to the building, entered into an agreement with the Marshall Land Company and with owners of other portions of the tract, whereby the various leases were extended from April 30, 1938, to April 30, 1968. (R. 22, 113)

After the acquisition of clear title to the Marshall land and the extension of the lease to 1968, no further activity of any kind became necessary on the part of the owners, other than the collection of rent. It was accordingly determined to dissolve the corporation. This was accordingly done, and on November 30, 1925, the corporation conveyed the land, which was substantially its only asset, to its four shareholders as tenants in common. They immediately thereafter conveyed the land to Fidelity Trust Company under the deed of trust here in question. (R. 23)

IV.

Specification of Errors Intended to Be Urged.

The Circuit Court of Appeals erred in affirming the decision of the Board of Tax Appeals, to the effect that the trust here in question was an "association" taxable as a corporation in the year 1934.

V.

ARGUMENT.

1. The Decision of the Court Below Conflicts With Decisions of This Court.

Section 801 (a) (2) of the Revenue Act of 1934 provides as follows:

> "The term 'corporation' includes associations, joint stock companies, and insurance companies."

The word "associations" has received no statutory definition, and its meaning has been left to judicial interpretation. Due to the conflict of decisions on the question of what trusts may be classed as "associations" and taxed as corporations, the Supreme Court a few years ago granted certiorari in four cases involving various sets of facts, and in deciding them reviewed and clarified the law on the subject. These cases are the leading case of *Morrissey v. Commissioner of Internal Revenue,* 296 U. S. 344, 80 L. Ed. 263 (1935); and the related cases of *Swanson v. Commissioner of Internal Revenue,* 296 U. S. 362, 80 L. Ed. 273 (1935); *Helvering v. Combs,* 296 U. S. 365, 80 L. Ed. 275 (1935); and *Helvering v. Coleman-Gilbert Associates,* 296 U. S. 369, 80 L. Ed. 278 (1935).

Any consideration of the law applicable to the present case must, therefore, start with a consideration of the decision in the *Morrissey* case, in which was written the opinion which governs all four of these cases.

In the *Morrissey* case this Court pointed out clearly that the test by which is to be determined whether a trust is an "association" does not lie in any of the formal features of the enterprise, but that the only test is whether the enterprise is in fact one *for the conduct of business.* As the Court said,

> "'Association' implies associates. It implies the entering into a joint enterprise, and, as the applicable regulation imports, an enterprise for the transaction of business. *This is not the characteristic of an ordinary trust—whether created by will, deed, or declaration—by which particular property is conveyed to a trustee or is to be held by the settlor, on specified trusts, for the benefit of named or described persons.* Such beneficiaries do not ordinarily, and as mere cestuis que trust, plan a common effort or enter into a combination for the conduct of a business enterprise. Undoubtedly the terms of an association may make the taking or acquiring of shares or interest sufficient to constitute participation, and may leave the management, or even control of the enterprise, to designated persons. But the nature and purpose of the cooperative undertaking will differentiate it from an ordinary trust. *In what are called 'business trusts' the object is not to hold and conserve particular property, with incidental powers, as in the traditional type of trusts, but to provide a medium for the conduct of a business and sharing its gains.* Thus a trust may be created as a convenient method by which persons become associated for dealings in

> real estate, the development of tracts of land, the construction of improvements, and the purchase, management and sale of properties; or for dealings in securities or other personal property; or for the production, or manufacture, and sale of commodities; or for commerce, or other sorts of business; where those who become beneficially interested, either by joining in the plan at the outset, or by later participation according to the terms of the arrangement, seek to share the advantages of a union of their interests in the common enterprise."[4]

The Court then analyzed what are "the salient features of a trust—when created and maintained as a medium for the carrying on of a business enterprise and sharing its gains—which may be regarded as making it analogous to a corporation organization?" These features the Court found to be continuity of ownership; centralized management, with trustees who act "in much the same manner as directors"; security from the termination or interruption of business by the death of the owner of a beneficial interest; ready transferability of beneficial interests; and the "limitation of the personal liability of participants to the property embarked in the undertaking." The Court hastened to add, however,

> "It is no answer to say that these advantages flow from the very nature of trusts. For the question has arisen because of the use and adaptation of the trust mechanism. The suggestion ignores the postulate that *we are considering those trusts which have the distinctive feature of being created to enable the participants to carry on a business and divide the gains which accrue from their common undertaking,*—trusts that thus satisfy the primary

---

[4] 296 U. S. at pp. 356-357, 80 L. Ed. at pp. 270-271. The italics have been supplied.

conception of association and have the attributes to which we have referred, distinguishing them from partnerships. *In such a case,* we think that these attributes make the trust sufficiently analogous to corporate organization to justify the conclusion that Congress intended that the income of the enterprise should be taxed in the same manner as that of corporations."[5]

It is thus clear that the features of limitation of personal liability, ready transferability of beneficial interests, etc., are not the real tests, because these features admittedly "flow from the very nature of trusts"; but that the only decisive test is whether the trust in question has the "distinctive feature" that its associates have embarked upon a *business enterprise,* and have not adopted the trust device merely in order to "hold and conserve particular property." The words "business" and "enterprise" imply activity, initiative, risk; they imply an effort to win a profit through active and skillful management. The mere holding of property and the collection and distribution of the rents therefrom have none of these implications.

As the Supreme Court said in the passages above quoted, a trust will be considered an "association" if it is engaged in "*dealings* in real estate," or "the *development* of tracts of land," as distinguished from merely holding a particular property and collecting the income therefrom; if it engages in "the *construction* of improvements, and the *purchase, management* and *sale* of properties"; if it engages in "production," "manufacture," "commerce"—if, in short, it is engaged in an *"enterprise."*

---

[5] 296 U. S. at pp. 359-360, 80 L. Ed. at p. 272. The italics have been supplied.

A year after its decision in the *Morrissey* and the related cases, this Court again had occasion to define what is an "ordinary trust," taxable as such, and not taxable as an association. In *A. A. Lewis & Co. v. Commissioner,* 301 U. S. 385, 81 L. Ed. 1174 (1936), a tract of land was conveyed to a trust company, in trust for the grantor and another. The object of the grantor was to divide and sell the land, and the trustee was given power to execute conveyances of title, as directed by the other beneficiary. The trustee was to collect payments received and distribute them to the beneficiaries, but was to have nothing to do with the sales of the lots or with negotiations leading up to them. This Court said,

> "The arrangement here answers the foregoing description of an ordinary trust—that is, it was created in virtue of a declaration by which *a designated piece of real property was conveyed to the trustee on specified trusts, for the benefit of definitely named persons,* one of whom was the grantor of the land and the other an agent of the grantor for the sole purpose of subdividing and selling the land. * * *"[6]

The essential feature of the corporate device is that it permits taking the risks involved in engaging in a business enterprise without exposing the entire fortune of the shareholder to possible loss. It is socially desirable that investors be encouraged to take risks in the development of new enterprises, by permitting them to limit their risk. It is this privilege which, on the other hand, justifies the taxation of the income of corporations at a higher rate, and the taxation at the same rate of an enterprise which, while differing in *form,* accom-

---

[6] 301 U. S. at pp. 388-389, 81 L. Ed. at p. 1176. The italics have been supplied.

plishes the same *purposes.* But where the trust is of the traditional type and is engaged merely in holding property, in preserving the corpus of the trust, and in collecting and distributing the income therefrom, its activities have no economic similarity to engaging in a business enterprise. Regardless of similarities in *form,* its *purpose* is wholly different; and there is no basis for taxing a trust of this character upon any analogy to a corporation.

By every standard laid down in the *Morrissey* and *A. A. Lewis & Co.* cases, the present trust is a strict trust:

a. *The Trust Was Limited to a Particular Property.*

Reference to the deed of trust (R. 81) indicates that the deed embodied a conveyance of a particular tract, and that the conveyance was upon trusts, all of which had relation *to that particular property.* The trustee was to hold "the said premises"; to lease "the said premises"; to oversee the payment of taxes, insurance, etc., "upon the said premises"; to sell the whole or any part of "the said premises," etc. This is not a trust to engage in the *business* of owning, developing and operating real estate generally as was the case in the *Morrissey* case, the *Coleman-Gilbert* case, or in other cases which follow them. The trustee had no power to acquire any other property of any kind. There *could be* no *"dealing"* in property.

b. *The Trust Was of Limited Duration.*

When the property was conveyed to the trustee it was already subject to leases extending to April 30, 1968. It is to be noted that, although the trust might

be terminated sooner at the will of the beneficiaries or by the death of all of them, the trust was at all events limited in duration to that date. (R. 84). This is different from the usual business trust which is generally set up to continue in existence for the maximum period permissible under statutes against perpetuities.

c. *The Trust Had a Definite Body of Beneficiaries.*

While admittedly the number of beneficiaries is not controlling in determining whether a trust is an "association," it may be noted that the present trust agreement manifestly does not contemplate a changing body of beneficiaries, analogous to the changing body of stockholders of a corporation. Not only is there no provision for the issuance of certificates of interest, but there is no specific provision in the deed of trust for the assignment of interests of beneficiaries.[7]

d. *The Trust Was Not Operated as a Separate Entity.*

The record will be searched in vain for anything to indicate that the trustee here acted "in much the same manner as directors." On the contrary, this property was administered by the trust company in the usual course of its business, just like all other properties which

---

[7] In fact, the question of assignment is referred to, quite indirectly, in only two places in the deed of trust, once at the point at which the beneficiaries "reserve unto themselves and their heirs and assigns, the right to revoke this instrument at any time" (R. 84) and again where it is provided that the trustee shall hold the property "to pay to the parties of the first part, their heirs, executors, administrators, and assigns, as their interest may appear, the net income from the property." (R. 85)

it held in trust. (R. 53, 61-62) The trust had no letterheads (R. 52, 62), no contact with the public (R. 52), no certificates of interest (R. 48, 52), and no employees (R. 62). The trustee held no stated or formal meetings with the beneficiaries. (R. 48, 52) The trust was administered exactly like "any one of a hundred decedents' estates under which the Fidelity Trust Company is trustee." (R. 53) The rental was received from the tenant by the real estate department of the trust company, just as it was for other trust estates. (R. 61-62)

e. *The Trust Had No Books of Its Own.*

The income and expenses of this trust were shown on the regular ledger sheets of the trust company, exactly like those used for all trust estates administered by the company. (R. 54-55) An examination of the ledger sheets which were offered in evidence (R. 131-141) will show the items of income and disbursement; the rent payments received; the payment of mortgage interest and amortization; the semiannual payment of the trustee's compensation; and the quarterly distribution among the beneficiaries of the balance available for them. The trust had no balance sheet (R. 54-59), and the reports made to the beneficiaries were quarterly statements of income and expenditures such as are made by all trust companies to beneficiaries of trust estates. (R. 54)

f. *The Trust Involved No "Management" in any Proper Sense.*

It is quite clear from the testimony that no "management" of any kind was involved in the present case, except such as is necessarily involved in the administration of any trust property. The sole asset of the trust was a single piece of property, long since leased to a

tenant under a long term net lease. Neither the trustee nor the beneficiaries had any part in the management of the building which the tenant had erected on this and the adjoining land, or in the department store which the tenant operated in the building. (R. 53) The trustee did not inspect the property to see if repairs were necessary (R. 53); it had no responsibility for insurance upon the premises (R. 53, 62); it had no responsibility for the payment of taxes, water rent, etc. (R. 53, 62)

It is true that, after the lessee defaulted and went into bankruptcy in 1932, it became necessary to negotiate a new lease; and this was done by a committee of two persons, one of whom was an officer of the trust company, acting on behalf of all of the property owners in the block covered by the department store. (R. 62-63) As a consequence, an agreement was entered into by all the property owners with the reorganized tenant, the effect of which was to reduce the rental stipulated in the lease. (R. 67) For the services of its officer in this connection, the trust company received a separate compensation from the Marshall heirs. (R. 63) While the court below appears to attach importance to this fact and seems to believe that this is something outside the ordinary and usual kind of trust administration, it is difficult to see how this is anything other than a necessary endeavor to protect and conserve the trust estate. It can hardly be regarded as engaging in the "conduct of a business," as the majority of the lower court appeared to think.

This is clearly not a case in which there was anything which might be described as the "creation of income through the enterprise and activities of the trustee."

g. *The Trust Was Not Used As a Device For Financing an Enterprise.*

In virtually every other case in which trusts have been held to be taxable as "associations," an examination of the facts will reveal that the trust device was used to facilitate the financing of a new business venture or undertaking. The trust device was used to permit the sale of beneficial interests just as certificates of stock in a corporation are sold. Nothing of that kind exists in the present case. The beneficiaries furthermore gave no thought to the question of guarding against personal liability of the beneficiaries. (R. 49)

h. *The Additional Powers of the Trustee Do Not Alter the Nature of the Trust.*

It is true that under the terms of the deed of trust, the trustee was given power, with the approval of a majority in interest of the beneficiaries, to borrow money to pay for the construction of a building on the premises or to sell the whole or part of the property. While the bare existence of these powers (though they were never exercised) led the majority of the court below to conclude that the trust is not to be regarded as a strict trust, that view seems wholly refuted by the following statement in the dissenting opinion:

> "* * * In the light of the fact that the trust estate consisted of a single tract of land entirely occupied by an existing business building leased to a single department store, the powers of the trustee to borrow money to construct a building on the land and to sell the whole or any part of the trust estate lose their significance." (R. 151)

2. The Decision of the Court Below Conflicts With Decisions of the Circuit Courts of Appeals for the First and Seventh Circuits.

The decision of the court below conflicts with the decision of the Circuit Court of Appeals for the Seventh Circuit in *Myers v. Commissioner,* 89 F. (2d) 86 (C. C. A. 7, 1937). In that case three brothers had an undivided interest in certain real estate on which was erected a store building, the prinicipal tenant of which was a corporation, of which the brothers were the sole shareholders, which conducted a clothing business. The old building burned down, and the brothers built a larger new one, the construction of which they financed in part by means of a mortgage loan. Thereupon they conveyed their interest in the land to themselves as trustees under a deed of trust which extended for a period slightly longer than the term of the mortgage on the property. The deed of trust provided for succession of trustees, assignable interest of beneficiaries, compensation of the trustees, etc. The Court, distinguishing the *Morrissey* case, and reversing the Board of Tax Appeals, held that:

> "It is thus seen that the trust in question was brought into being in relationship to a particular piece of property owned by three brothers as cotenants for many years. They had reached a period in their affairs when it was desired to replace the former improvements with a modern building. Their chief tenant of both the old and the new building was Myers Bros., the corporation, their own enterprise. * * * Motivated by a desire to protect their investment and to maintain the same intact during the time deemed necessary to liquidate the mortgage indebtedness, without the property being subject to the usual hazard of death and succession, they created the trust. * * *

"We think it reasonably clear on the facts stated that the purpose of this trust was not the operation of a business enterprise. The only business transacted by the trust was the keeping of the building in a tenantable condition and the collection of rents for the use of the owners of the beneficial interests. Instead of concluding that the trust was formed for a business purpose, rather do we think it fair to say that such business as it transacted was merely incidental to the broader purpose of preservation. The inception of the trust had no relation to the transaction of any business. The construction of the building had many months before been determined upon and was well on its way to completion when the trust was formed. Every trust of the purest type necessarily has attributes of a business organization. Its very existence depends on such. That characteristic alone cannot brand it as an 'association.' If the father of the three Myers brothers had by his will set up a trust estate for their benefit in the precise manner here indicated, it would have been almost typical of the traditional type of family trust. We think it none the less so that its creation has been by the three brothers."[8]

The foregoing language could, with hardly any change, be applicable to facts of the case at bar.

An earlier decision of the same court with which the decision in the case at bar conflicts is *Tyson v. Commissioner,* 54 F. (2d) 29 (C. C. A. 7, 1931).

The decision of the court below also conflicts directly with that of the Circuit Court of Appeals for the First Circuit in *Lansdowne Realty Trust v. Commis-*

---

[8] 89 F. (2d) at p. 89.

sioner, 50 F. (2d) 56 (C. C. A. 1, 1931). That case involved a trust of real property upon which was erected a building leased under a "net lease" to two tenants. The powers of the trustee were almost identical with those of the trustee in the case at bar. In that case the Court said:

> "* * * It is true that the trustees had powers of a broad character, but they did not exercise them and were not carrying on business after the form and manner of a corporation. When the trustees received the property, it had all been leased for a term of five years from March 1, 1920. During this period of five years the trustees were not called upon to seek tenants or to do anything with reference to the property of any consequence except to collect the rents and turn them over to the beneficiaries. By the terms of the lease the lessees were to keep the premises in repair, pay the insurance, and be responsible for all damages connected with the building. It is perfectly apparent that they were not doing business in any sense, during the years 1923 and 1924, and we are of the opinion that, during the years 1925 and 1926, they were not conducting business after the mode and manner of a corporation, but were doing nothing more than trustees ordinarily would be called upon to perform in the management of trust property. * * *"[9]

Respectfully submitted,

CHARLES DENBY,
Attorney for Petitioner.

---

[9] 50 F. (2d) at p. 58.